Service Date: November 24, 1993

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER of U S WEST COMMUNICATIONS, INC.'S Petition for Declaratory Rulings on the Jurisdiction of the Commission Approval of Proposed Sale of Local Exchanges, and for Appropriate Allocation of Gain.	)	UTILITY DIVISION DOCKET NO. 93.5.23

DECLARATORY RULING

1. On May 28, 1993 U S WEST Communications (USWC or Company) filed a petition for declaratory rulings with the Montana Public Service Commission (Commission). The petition requested that the Commission find the proposed sale of 60 USWC Montana exchanges (see attached Exhibit A-Gary S. Duncan) to be in the public interest (or, in the alternative, that the Commission lacks jurisdiction). It also requested, based on the specific facts presented, that the Commission find fair and equitable the allocation to USWC shareholders of the entire gain that USWC expects to receive from the sale, provided that USWC invests an amount equal to the gain, in a program called Tele-Tech. TeleTech would include investments in a fiber overlay infrastructure, Signalling System 7 (SS7), Voice Messaging Services, Frame Relay Services, and "Tier 2" investments. See USWC Petition, Appendix C, and USWC Brief dated October 15, 1993, p. 15, footnote 11 and Letter from USWC Montana Vice President George Ruff dated November 4, 1993.

2. Several parties intervened in this Docket and filed testimony, including the Purchasing Companies (Nemont Telephone Cooperative, Inc.; Triangle Telephone Cooperative, Assn., Inc.; Blackfoot Telephone Cooperative, Inc.; Mid-Rivers Telephone Cooperative, Inc.; 3 Rivers Telephone Cooperative, Inc.; Range Telephone Cooperative, Inc.; Clark Fork Telecommunications, Inc.; Valley Telecommunications, Inc.; Project Telephone Company and Central Montana Communications, Inc.), the Montana Consumer Counsel (MCC), AT&T, and the Ronan Telephone Company. The Ronan Telephone Company subsequently withdrew its intervention and its prefiled testimony. MCI did not file testimony, but did intervene and participate in the case. PTI Communications intervened, but did not file testimony or otherwise participate.

3. The Commission held 31 satellite hearings to receive public testimony. It also held a technical hearing on September 21-23, 1993. The overwhelming majority of the testimony received at the satellite hearings was in favor of the sale of the exchanges, the allocation of the gain to USWC shareholders, and the modernerization of the Montana Telecommunication's infrastructure.

4. In its prefiled testimony, MCC opposed the allocation of the gain to USWC shareholders. It advocated that the Commission allocate the gain to USWC ratepayers. However, during the technical hearing, MCC appeared to be willing to concede that some of the gain could be allocated to USWC shareholders, if it

were invested at "a zero cost to capital." (See cross-examination of MCC witness Mr. Buckalew, TR pp. 332-336.)

5. On November 2, 1993 the Commission received from MCC and USWC a settlement agreement which, in part, pertained to the issues disputed by them in Docket No. 93.5.23. Particularly, the first point of the agreement states:

> As a result of this settlement agreement, MCC withdraws any opposition to the issuance of the declaratory ruling regarding allocation of gain requested by USWC in PSC Docket No. 93.5.23. MCC requests that the Commission consider and treat its earlier objections as withdrawn, and urges the Commission to issue the ruling requested by USWC.
>
> Settlement Agreement, p. 2.

6. In view of the above, the Commission APPROVES the declaratory rulings as requested by USWC. Additionally, the Commission finds as follows:

A review of the Petition, the record, the settlement agreement and the great majority of public testimony in this matter appears to suggest that there will be no threat from the consummation of this sale, to either the adequacy or availability of service to utility customers. The Purchasing Companies have proposed to adopt USWC rates, and have stated that their future rates should be lower than those of USWC. Thus, it appears that the transfer of ownership as requested by USWC and the Purchasing Companies will not adversely affect present or future rates. The Purchasing Companies appear to be willing and able to assume the service responsibilities associated with the 60 Montana exchanges currently owned by USWC. Several of the proposed new owners appear to have the financial and other resources necessary to provide adequate, modern service in the future, that will be at least as good as that of USWC, if not better. Thus, the record, including the public testimony, appears to demonstrate that the sale of these 60 Montana exchanges will not result in inadequate service or unreasonable rates.

USWC has stated that it will invest the gain from the sale in modern fiber optic telecommunication facilities and other telecommunications infrastructure improvements in Montana, something that was supported by many public witnesses at the satellite hearings. The Commission does not decide here whether those facilities will be used and useful in providing service. The Commission lacks any legal authority to pre-approve public utility investments, so the investments USWC has committed to in this case, just as all utility investments, must be subject to full regulatory scrutiny in a future rate case after the investments are in place. See generally, § 69-3-109, MCA.

USWC has agreed in the settlement agreement to reduce its rates by $6 million annually beginning on January 1, 1994. In addition, it has agreed to increase its depreciation expense by $1 million annually, with corresponding adjustments to its accumulated depreciation reserve. The settlement agreement states:

> If the Commission decides not to issue the declaratory rulings requested by USWC in Docket No. 93.5.23, this agreement is null and void, of no force and effect, and neither party has any rights under it.
> Settlement Agreement, p. 4.

The Purchasing Companies have agreed to exclude any and all plant acquisition adjustments for purposes of intrastate and interstate price setting. Presumably, this includes all direct and indirect impacts from payments which exceed the net book values of the 60 exchanges.

The public testimony expressed an overwhelming public opinion in favor of the sale. USWC also took the position in this case that the sale would not occur unless the allocation of the gain to its shareholders was approved.

7. The Montana Public Service Commission has jurisdiction over U S WEST Communications in the provision of intrastate regulated telecommunications services, and the sale of Montana telephone exchanges. §§ 69-3-803(3), 69-3-101, 69-3-102, 69-3-103, 69-3-110, 69-3-201, MCA. The Commission has affirmed its authority over the sale and transfer of public utility assets in a number of previous decisions. See, e.g., In the Matter of the Application of Montana-Dakota Utilities, Docket No. 92.11.74, Order No. 5688; In the Matter of the Application of Midvale Water Service Docket No. 91.3.4, Order No. 5553; In the Matter of the Application of Redgate Water Company, Docket No. 90.10.64, Order No. 5517; and In the Matter of the Application of Montana Light and Power Company, Docket No. 87.8.46, Order No. 5311.

ORDER

IT IS HEREBY ORDERED THAT:

1. The sale of the 60 USWC exchanges to the Purchasing Companies is APPROVED and is found to be in the public interest.

2. The allocation of the gain as requested by USWC is APPROVED. The allocation of the gain to USWC shareholders is expressly conditioned upon the provision of adequate telecommunications services by USWC, and the investment of the net gain on this sale in Montana telecommunications infrastructure improvements (over and above the amount USWC would otherwise invest in Montana over the next 36 months).

3. In issuing this ruling, the Commission expresses no opinion or decision whatsoever on any other issue or matter which has been brought to its attention in this case, including but not limited to whether future investments by USWC or other telecommunications companies will be used and useful, any possible changes to the Federal Universal Service Fund, the reasonableness of the rate provisions of the settlement agreement or any future rates, or on any specific provision in the sales agreements between USWC and the Purchasing Companies.

4. This Ruling is based upon a very unique set of facts and circumstances, and does not set Commission precedent, or vary any previous Commission precedent.

Done and Dated this 22nd day of November, 1993 by a vote of 4-1.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

Bob Anderson

BOB ANDERSON, Chairman

Bob Rowe

BOB ROWE, Vice Chairman
(Concurring in Ordering ¶¶ 1 & 3 and Dissenting to Ordering ¶ 2 - Attached)

Dave Fisher

DAVE FISHER, Commissioner

Nancy McCaffree

NANCY MCCAFFREE, Commissioner

Danny Oberg

DANNY OBERG, Commissioner

ATTEST:
Kathlene M. Anderson
Kathlene M. Anderson
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.

Exhibit A
Gary S. Duncan
Affidavit

WIRE CENTERS BY PURCHASER

COOPERATIVE	WIRE CENTER	TOTAL ACCESS LINES 30-Apr-93
BLACKFOOT	ALBERTON	321
	DRUMMOND	522
	HAUGAN	155
	NOXON	532
	PHILIPSBURG	641
	PLAINS	1,198
	ST REGIS	338
	SUPERIOR	931
	THOMPSON FALLS	1,628
	TOTAL - 9 WIRE CENTERS	**6,266**
MID-RIVERS	BAKER	1,307
	LAVINA	138
	MELSTONE	172
	ROUNDUP	1,650
	RYEGATE	214
	SAVAGE	186
	TOTAL - 6 WIRE CENTERS	**3,667**
NEMONT	BAINVILLE	164
	BROCKTON	110
	CROW AGENCY	508
	CULBERTSON	588
	FLAXVILLE	73
	FORT PECK	219
	FORT SMITH	208
	FROID	150
	GLASGOW	2,645
	HINSDALE	149
	LODGE GRASS	409
	MEDICINE LAKE	202
	NASHUA	207
	OPHEIM	110
	PLENTYWOOD	1,342
	POPLAR	930
	SACO	231
	SCOBEY	726
	WOLF POINT	1,805
	WYOLA	101
	TOTAL - 20 WIRE CENTERS	**10,877**

Exhibit A
Gary S. Duncan
Affidavit

WIRE CENTERS BY PURCHASER

COOPERATIVE	WIRE CENTER	TOTAL ACCESS LINES 30-Apr-93
RANGE	BROADUS	550
	TOTAL - 1 WIRE CENTER	**550**
3-RIVERS	BELT	505
	BRADY	178
	CHOTEAU	1,348
	HIGHWOOD	196
	LIMA	308
	MELROSE	149
	NEIHART	198
	SHERIDAN	811
	TWIN BRIDGES	453
	VALIER	442
	VIRGINIA CITY	172
	TOTAL - 11 WIRE CENTERS	**4,760**
TRIANGLE	DENTON	328
	DODSON	116
	FORT BENTON	1,064
	GERALDINE	320
	HARLEM	842
	HARLOWTON	871
	HOBSON	347
	JUDITH GAP	150
	MALTA	1,629
	MARTINSDALE	146
	MOORE	268
	STANFORD	499
	WHITE SULPHUR SPRINGS	769
	TOTAL - 13 WIRE CENTERS	7,349
ALL	**TOTAL ACCESS LINES (60 WIRE CENTERS)**	**33,469**

OPINION OF COMMISSIONER ROWE

I. INTRODUCTION.

I strongly support provision of high-quality rural telecommunications service, which should be achieved through the sale of exchanges to the six purchasing cooperatives. I also support timely modernization of the telecommunications network, both urban and rural. I believe both objectives are best realized through thoughtful application of sound regulatory principles. Those principles should be applied both in response to immediate demands, and with a long-range view. The utilities this Commission regulates take a long-term perspective; so should this Commission. That is our job, even when unpopular.

The sales price in this case, $124.8 million, is 1.7 times book value. That creates two problems. First, it burdens the purchasers, their members and customers, with an enormous debt. Second, it creates a net "gain" above book value, at least $29.2 million after tax and probably more. If all or part of that gain is properly the ratepayers', allowing the shareholders to retain the gain in exchange for an equal "reinvestment" in Montana utility property potentially requires ratepayers to pay twice, plus interest. They paid once when they paid depreciation and a rate of return on the utility's property. They will pay a second time if the utility's new investments are found used and useful and included in ratebase. And, ratepayers will pay a "rate of return" on that investment. The amount at issue therefore, is vastly larger than $30 million, or "fifty dollars per customer," as has been suggested.

The agreement between US West (Applicant) and Montana Consumer Counsel (MCC) represents a good first step, and probably is a solid post-sale adjustment, consistent with the Applicant's financial situation after the sale. It fails to address equitable allocation of the gain. Treatment of gain is a fundamental issue in this case. The Commission's action in allocating gain to the shareholders also raises concerns about precedent for future cases. These concerns may be minimized, but cannot be fully avoided.

In light of the foregoing, I strongly concur in the determination that the Montana Public Service Commission has jurisdiction over the proposed sale of 60 rural telephone exchanges by US West, and that the sale is in the public interest. I dissent from the determination that gain on the sale should be awarded to shareholders.

Part II of this opinion discusses whether the sale is in the public interest. Part III discusses allocation of the gain. Part IV discusses additional issues of concern, including a proposal for least-cost telecommunications planning, intended to avoid repetition of the "most cost" result obtained in this case.

II. PUBLIC INTEREST.

The first of two declaratory rulings which US West requested the Commission to issue was that either the Commission has no jurisdiction over the sale, or that the sale is in the public interest. I moved that we exercise jurisdiction and determine the sale to be in the public interest, based primarily on rates and service in the exchanges to be sold. The motion passed unanimously. The Commission promptly communicated this determination to the Federal Communications Commission by letter, in order to expedite final FCC action.

The determination that the sale is in the public interest is based primarily on extensive public testimony at the satellite hearings, purchasers' responses to data requests, and the testimony of Paul Stav and Richard Thronson.

A. Rates.

The effect on rates in the sold exchanges should be neutral or favorable. This is based primarily on the testimony of Joan Mandeville. This is not unqualified, due to the speculative nature of long-term conditions, and because the Commission cannot as part of this case issue a binding order concerning future rates. Generally, the purchasers propose to adopt US West's present rates, which are higher than the purchasers' current rates to their existing customers.

Because provision of local service is declining-cost overall, the Commission should expect to see the purchasers reduce rates for the purchased exchanges in the future. Further, the purchasers should attempt to match the approximately four percent reduction in US West rates negotiated by the Montana Consumer Counsel and US West.

B. Service.

The effect on service in the sold exchanges should be positive. The purchased exchanges will receive significantly-improved service due to installation of digital switching, either by US West or by the purchasers; this is the only upgrade to which either the purchasers or the seller are bound, either by contract or prior Commission order. However, the record established that in many areas the purchasers will exceed these levels, in terms of capital improvements, prompt attention to repair and service complaints, elimination of held orders, and overall service quality.

The testimony of Stav and Thronson concerning the non-quantifiable elements of customer service was particularly impressive. This includes efforts to meet specific local needs, and outreach to customer groups with lower penetration rates or who otherwise do not fully participate in the telecommunications system, such as Native Americans residing on reservations. Both rationalized, quantifiable service standards and delivery methods and the less-quantifiable first-person approach to service are essential. The purchasers' approach contrasts with US West's recent decision to further reduce its service presence in Montana.

Another example of the purchasers' commitment to first-rate service concerns the time it takes to respond to service requests, such as provision of new service. US West is currently under a Commission order to show cause for excessive "held orders" over thirty days (PSC Docket N-93-14). The purchasers strive to meet service requests within several days.

The record established that the purchasers provide very high service quality and customer service. However, in some instances they do not appear to keep the same kind of service standard or customer service information as do regulated utilities. As the purchasers grow, the quantifiable aspects of service quality and customer service may become more important. The non-regulated purchasers are encouraged to adopt more formal standards, recording of complaints, and customer service policies.

C. **Other Considerations**.

Other factors raised initially by the Commission and addressed by the parties may be significant, but are secondary to rates and service.

1. **Local Economic Impacts**.

The economic well-being of the sold exchanges will be benefited by the sale. "Economic development" is not so much an independent factor, but rather is best addressed through close attention to rates and service. The basic requisites for high-quality rural telephony will be met by the switch upgrade. As noted, the purchasers have in many cases committed to go beyond these steps. While these additional commitments are not necessarily legally-binding, they have been repeatedly and publicly stated.

The "Aspen Report," cited by Dr. Power, lists ten goals for rural service: 1. Make voice service available to all. 2. Make single-party access to the switched network available to all. 3. Improve quality sufficiently to allow rapid and reliable transmission of data and facsimiles. 4. Provide equal access to long distance carriers. 5. Provide local access to value-added networks. 6. Provide 911 service with automatic number identification. 7. Expand mobile service. 8. Provide touch tone and custom calling services. 9. Provide local voice messaging service. 10. Provide the services which become generally available in urban areas. E. Parker, <u>Rural America in the Information Age</u> (1989). The purchasers are well-positioned and committed to further achievement of these goals.

In many cases, the purchasers will hire current US West employees. Many of these employees appear to support the sale. The purchasers' plans for additional hiring appear consistent with provision of high quality service, rather than gold-plating.[1]

Possible adverse local tax effects were initially of concern to some local governments. Blackfoot, Triangle, and Nemont will operate regulated subsidiaries, which will be taxed at the same

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[1]For those purchasers which will be regulated, this statement does not alter the need for "used and useful" review of actual utility expenditures.

level as would be US West.[2] In other areas, there will be some adverse tax effects, partially offset by other factors such as increased investment. MCC observed that in the aggregate US West's switch commitment plus its business as usual expenses would exceed the investment proposed by the purchasers. In the areas which may face adverse tax effects, customers and local officials nonetheless supported the sale.

2. <u>**Universal Service Fund and Carrier Access Charges**</u>.

According to testimony from the Purchasers and AT&T, Universal Service Fund alterations currently under consideration would not likely affect the purchasers. The Commission should consider in a separate work session whether resources permit it to participate in the Federal Communications Commission docket (Common Carrier Docket CC-80-286). If the Commission elects to participate, its position on behalf of Montana ratepayers would not necessarily be that advocated by AT&T.

At the hearing, AT&T changed its position concerning the proposed carrier access charge, deciding it was not acceptable. This issue was not fully addressed by all the parties. Not all potentially affected companies participated in the hearing. Concern about carrier access charges is not sufficient to overcome a determination that the sale is in the public interest.

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[2]There was some concern expressed that customers in these areas would not enjoy the full benefits of cooperative membership, but the arrangement was nonetheless strongly supported in the affected communities.

3. <u>Financial Condition</u>.

The purchasers' financial condition appears adequate to provide high-quality service at affordable prices. The purchasers' financial condition was evaluated by the seller, through an internal review by the purchasers, and to some extent by prospective lenders. Possible near-term changes in the federal Universal Service Fund would not appear to jeopardize the purchasers' ability to meet their commitments. It should be noted that several of the purchasers project initial negative cash flows and negative income as a result of the transaction. Not all purchasers provided the same detail of financial analysis. But for the sales price, there would be much less concern about the purchasers' financial condition.

4. **<u>Sales Price</u>.**

Although the price was negotiated between knowledgeable parties, the last decade has provided far too many examples of inflated sales prices harming innocent third parties. Even more troubling is the history of inflated speculative trades of property between utilities leading up to the Public Utility Holding Company Act of 1935 (PUHCA).

Because the third parties in this case are recipients of essential telecommunications services, it would be cavalier to pretend concerns do not exist. The sales price is 1.7 times the book value of the assets. On a per-line basis, the price is approximately twice the cost of building the system from the ground up, an option suggested by the Montana Consumer Counsel; this does not take into account the additional cost of replacing some of the equipment included in the purchase with new digital equipment in order to fulfill the existing modernization commitment.

The purchasers themselves were concerned with the price, and had initially made an offer on a set of exchanges at a lower ratio to book value. Further, the purchase does represent a significant cash flow out of Montana; a majority of the funds will be reinvested elsewhere.

A compelling argument exists, drawing on the history of abusive financial transactions between utilities and the PUHCA reforms, that sales of utility property to other utilities above book value should never be approved. After all the horizontal or vertical efficiencies have been achieved, some customer class of some utility is at risk of paying more than they should for utility service. A change in ownership of property dedicated to the public use should never cause an impact on rates or ratepayers. Perhaps because attention was focused on the analysis in Butte Water Company v. P.S.C., Docket No. 86.3.7, Order No. 5194, aff'd Cause No. CDV-87-013, Montana First Judicial District 1988, which involved a sale of utility property to a non-utility, this specific issue was never addressed. In future cases, the Commission should raise the issue on its own motion.

I approached concerns about the impacts of the price on the purchasers by encouraging the parties to address it in negotiations related to treatment of gain. That was not the outcome negotiated by the parties.

Finding that the sale is in the public interest does not constitute pre-approval of the specific terms of the sale agreements. Specifically, initial rates and access charges must be filed with the Commission and acted on through conventional means.

III. ALLOCATION OF THE GAIN.

The second declaratory ruling requested by US West was that the gain should be allocated to the shareholders "as compensation for partial liquidation ... provided that USWC pursues" TeleTech. US West expressly acknowledged that it had the burden of proof, asserting and receiving the procedural advantages which go with that burden. Further, it is fair to infer from the fact that US West requested a declaratory ruling concerning gain, and that it styled its request as fact-specific, that it recognized its position was a deviation from established policy. This Part first applies the Butte Water analysis, then evaluates the specific exceptions proposed by US West and finally discusses the agreement reached between MCC and US West.

A. Economic Burden and Risk of Loss.

The Commission should affirm its general policy, enunciated in Butte Water, that the right of gain should follow the risk of loss, and benefits should follow the economic burden.[3] Under the Commission's established analysis -- without yet considering whether exceptions should be allowed as "compensation for partial liquidation" or for the proposed TeleTech investment -- the net gain in this case should flow to ratepayers.

At the outset, the analogy to private unregulated business should be addressed. A Main Street entrepreneur accepts the risk of loss, including the risk associated with technological obsolescence. A cinema may be displaced by a video store. In turn, the video store may be replaced by the phone company or the cable company providing movies on demand. In both cases, the consequences for the private business owner are severe and immediate.

In contrast to the private business, once an asset is included in rate base, a regulated utility is assured the opportunity to earn a reasonable rate of return. For these assets, the primary risk faced by the utility shareholder is that associated with bad management. US West has received incentives to replace old facilities, and depreciation adjustments to reflect technological change. It has not had to write off assets or take

[3]As all parties recognize, the Butte Water approach was not fashioned from whole cloth. It is part of a large body of utility law and policy concerning allocation of gain. See, Democratic Central Committee of the District of Columbia v. Washington Metropolitan Area Transit Commission, 485 F2d 786 (1973).

a loss on its Montana operations. It has always been awarded a rate of return sufficient to attract capital. Through paying his or her utility bills, the Main Street entrepreneur helps provide the regulated utility this unique degree of security. The analogy between the Main Street entrepreneur and the regulated utility is derailed before it leaves the station.

If US West wishes to retroactively rewrite the regulatory bargain, perhaps it should reimburse ratepayers for various adjustments, incentives and other payments it has previously received. In the future, perhaps US West should be expected to aggressively write off obsolete assets which are now included on its regulatory books. The discussion now turns to the Butte Water analysis.

1. **Economic Burden**. Ratepayers have paid all expenses associated with the property being sold, specifically including taxes, administrative and general expenses, operating and maintenance expenses.

2. **Risk of Loss**. Ratepayers have (1) paid a rate of return on the investment; (2) paid depreciation on the investment; (3) paid an incentive rate of return on Rural Telephone Improvement Program investments in these properties; (4) paid accelerated depreciation and amortization, including in aid of the rural switch upgrade, an upgrade which has not been completed in over fifty of the sixty exchanges being sold. Shareholders have not faced a loss or write-off on their regulated Montana investments.

At page 9 of its brief, US West quotes a portion of Butte Water Order 519a, Finding of Fact 42, emphasizing the Commission's discretion:

> In every case, the Commission must balance its obligations to the equity investor to maintain financial integrity, attract necessary capital, and fairly compensate investors with its obligation to the ratepayer to set reasonable rates and protect the existing and foreseeable public interest. The unique facts and circumstances of each rate case influence this balancing.

As the applicant would likely remind the Commission in other contexts, the Commission's discretion is not boundless, and must be applied in a principled manner. The facts and circumstances adduced in this proceeding demonstrate that, were gain from the sale to go to ratepayers in some form, the sale would still improve the utility's financial integrity, preserve its ability to attract capital, and fairly compensate investors.

B. Partial Liquidation and TeleTech.

US West offers two bases for an exception to the Butte Water approach: First, a lost stream of revenues and business opportunities resulting from partial liquidation and second, the TeleTech investment. Both justifications were thoroughly eviscerated through the discovery and hearing process.

1. "Partial Liquidation."

Through the payment of actual depreciation by ratepayers, US West has already recovered all of its investment other than the net book value. Because rates in Montana are averaged, the exchanges to be sold are the least profitable, or standing alone would produce no positive return. Discovery and live examination confirmed that US West is selling its least lucrative exchanges. US West will be freed to invest the net book value, $73.5 million, in other potentially more profitable endeavors. There will be no lost stream of revenue.

US West will benefit from avoidance of the outstanding $31 million investment in digital switches for the sold exchanges, which it would have been required to complete had the sale not gone through. Benefits will also include greater operational efficiency, less dilution of managerial resources, avoidance of ongoing maintenance expenses, avoidance of business as usual capital expenditures and redeployment of capital resources to more lucrative urban areas. Had the Commission affirmed its policy and awarded net gain to ratepayers, it would have been economically irrational for US West to walk away from the sale.

2. **TeleTech**.

US West will invest approximately $28 million in technology upgrades for the six largest cities in its service area. Public testimony at urban hearings supported these investments. While US West studies did not demonstrate a near-term demand for each element of TeleTech, the Applicant did contend the program would be fully used and useful. US West will submit TeleTech for rate base treatment in its entirety, probably within three years.

The Commission has at least twice granted incentives to support telephone improvement initiatives. The Rural Telephone Improvement Program (RTIP) involved an enhanced rate of return in exchange for an $82.4 million investment. The switch upgrade, if fully completed by US West, would have cost approximately $90 million, for which US West received a regulatory "signal" in the form of an FCC represcription and a reserve deficiency amortization, worth a total of slightly over $3 million.[4] Both programs received quite modest incentives or signals in relation to the magnitude of the investments undertaken.

In the present case, US West requested and received a one hundred percent subsidy that may be used in anticompetitive ways. Extraordinary incentives usually are not appropriate, even for deployment of new technology. When granted, incentives should be consistent with sound regulation, and should be the least-cost means to achieve the desired ends.

If the Butte Water analysis is correct, and if the lost stream of revenue argument is found insubstantial, the TeleTech proposal would at most support treating the net gain as customer contributed capital in support of TeleTech. I raised this approach; it was rejected. The difficulty with US West's proposal is that customers will be asked to pay $28 to $30 million not once (at the time of sale) but twice and with interest, when

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[4]The Commission's decision in Docket 90.12.86 was careful not to specifically characterize these adjustments as a "signal" to US West.

TeleTech is proposed for rate treatment. Therefore, I would consider the net gain to be customer contributed capital.

C. **The MCC and US West Agreement**.

I strongly support direct incorporation of settlement processes into Commission deliberations, by analogy to judicial management of settlements in federal court.[5] Generally, negotiations are possible where the ultimate decision-maker sets clear standards or has done so previously, where the parties have relatively equal bargaining power and motivation, and where both parties disclose their true interests and work together to ensure those interests are met.

Here, those conditions did not exist. Specifically, the Commission failed to reaffirm its policy concerning gain or give formal guidance to the parties, as I had urged. Therefore, the Applicant had little objective incentive to negotiate. The results of negotiation confirm this. Because of the Commission's failure, MCC was left to pursue damage control on behalf of the ratepayers.

As I have repeatedly asserted, this is a case which should have been easily settled with substantial benefits to all parties. Among the outcomes consistent with the foregoing analysis of risk and burden are the following:

(1) Equitable sharing of the gain.

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[5]See Manual for Complex Litigation, Part 23 (2d ed. West 1985); Negotiated Settlement of Utility Regulatory Proceedings (Center for Public Resources 1993).

(2) Treating the gain as full or partial customer contributed capital in aid of modernization investments.

(3) Reduction of the sale price, pegged to all or part of the gain in the originally-negotiated transaction.

The agreement presented by MCC and US West is a step in the right direction. The direct participants on both sides are commended for their very hard work under clearly difficult circumstances.

The agreement calls for a rate decrease of $6 million, together with a $1 million increase in annual depreciation expenses. Neither party will propose a rate increase or decrease until 1995 (meaning a resultant rate change might not take effect until mid-1995). The agreement does not purport to bind the Commission.

Because basic telephone service is generally a declining cost industry, a one year period of repose is not absolutely in the ratepayers' interest. Further, the agreement appears to preclude MCC from advocating any reductions based upon savings from US West's recently-announced "re-engineering" program. On the other hand, a rate reduction effective January 1, 1994, avoids the delay which would be involved in achieving any possible rate reduction through a contested case and does benefit customers.

Both parties disclaim any connection between the settlement and allocation of the gain. Instead, the true value of the settlement to ratepayers must be evaluated in the context of US West's updated financial showing, recently filed with the Commission as docket 93.7.25. The Commission staff has had no opportunity to evaluate that filing. However, the filing does indicate a $6.3 million benefit to US West as a direct result of selling the 60 rural exchanges. This must be taken into consideration in determining the true value of the settlement.[6]

There were at least three preferable alternatives. First, given the importance of the issues involved, the best course would have been for the Commission to reject the settlement, and refer the case back to the parties with additional guidance consistent with the foregoing discussion. The Commission did not do this.

Second, a less-acceptable approach would have been to act in accordance with the settlement, with the proviso that the rate

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[6]The updated financial showing also purports to demonstrate a total revenue deficiency of about $9 million. But for the settlement, this amount would be formally analyzed by the Commission, MCC and other parties. Based on previous experience this amount would quite possibly be reduced or eliminated.

A Commission staff "first take" analysis is that a rate reduction which would have resulted from a rate case based upon the financial showing could be $3 million annually. If the settlement reduction remained in effect through mid-1995, the total additional value of the settlement rate reduction would be perhaps $5.25 million. The discounted value of the depreciation adjustment might be another $2.05 million. This is all extremely speculative; it is not contained within the four corners of the record now before the Commission. Yet it is instructive to compare the total benefit of the agreement, net of adjustments which would have resulted from analysis of the financial showing, perhaps a little less than $6.9 million, to the much larger amount of ratepayer money US West will be allowed to keep as a result of the Commission's order in this case.

reduction is separate from anything which might be demonstrated by review of the financial showing in 93.7.25, and to initiate a formal review of that filing at the Commission's own motion. Because MCC is committed to a "period of repose" during which it may not advocate rate reductions, it might have been necessary for the Commission to designate certain of its own staff and a consultant as an advocacy team for such a docket.

Third, had the Commission affirmed that consistent with its established policy net gain in this case belongs to ratepayers, and had US West for whatever reasons decided not to go through with this sale at this time, modernization would not have been dead. US West would have undertaken significant modernization efforts in any event, to fulfill the switch upgrade commitment, to meet FCC requirements, and to remain competitive. Public testimony would have supported the Commission opening a docket to order additional improvements. Because the sale made economic sense from US West's perspective, it is possible and even likely that a sale would have occurred in the near future. This Commission should attempt to look into the future at least as far as do the utilities it regulates.

Despite the best efforts of the direct participants in the negotiations, the agreement fails to address the basic principles of sound regulation applied by this Commission. Therefore, I vote against the second requested declaratory ruling.

IV. ADDITIONAL MATTERS.

A. Role of the Montana Consumer Counsel.

No party's case receives special weight from the Commission. However, the Consumer Counsel performs a unique and essential role in Commission proceedings. In many cases, it is the only party offering testimony contradicting an applicant's position. If the Consumer Counsel is weakened, the Commission is less able to do its work, and Montana customers suffer. In some states, consumer counsel offices (and public service commissions as well) have been subject to extreme political pressure (particularly from phone companies), and have been diminished in their effectiveness as a result.

The Consumer Counsel's position in this case was extremely unpopular, and was widely misrepresented. However, MCC provided essential balance to the cases presented by the other two principal parties. As other adversarial parties withdrew from the case, MCC's involvement became more important. At the very least, MCC weathered the attacks to help achieve a benefit to ratepayers.

I am angry about the attacks to which the Consumer Counsel was subjected. The Legislative Consumer Counsel Committee deserves credit for its determination to stand by its position.[7]

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[7] One of the highlights of this hearing was Representative Quilici's off-the-record statement in support of the MCC position, delivered at the Butte public hearing.

B. <u>Role of Public Testimony</u>.

I take public participation in Commission matters very seriously. That is why public utility planning processes, informal community meetings, and the accessibility of Commissioners are important.

I treat public testimony in formal Commission cases as "real evidence," entitled to be weighed and evaluated as would other evidence. Ratepayers' testimony about their preferred provider of utility service was for me the weightiest evidence in support of finding the sale in the public interest.

Public testimony in urban areas, while evincing some uncertainty about the relationship between specific technologies and the particular services the witnesses desired, did provide compelling support for modernization. I became persuaded by that testimony that the Commission had a record sufficient to open a proceeding to order US West to upgrade its high-end services.

Taking public testimony seriously has certain implications. First, it becomes necessary to examine the witness sufficiently to determine the basis for their testimony. This is particularly true of opinion testimony. This should always be done in a respectful way.

Second, the parties must themselves take public testimony seriously. A witness testifying at the request of a party at some point becomes a witness of that party. In transportation cases, if a public witness has had specific contact with a party concerning their testimony, I ask the witness to testify during that party's case. In utility cases, it might be appropriate to give parties an opportunity to call lay witnesses during satellite hearings.

Parties, the Consumer Counsel, and the Commission, all have legitimate responsibilities to educate and involve the public. That is not carte blanche for regulated utilities to organize pressure campaigns or use members of the public to circumvent restrictions on ex parte contact (i.e., it is unlawful for a utility official to contact a commissioner directly to discuss the substance of a contested case). The Applicant in particular should realize that the horse it rode today will probably kick it in the head tomorrow.[8] Outside the heat of a contested case, we all need to reconsider our approaches to these issues.

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[8]At page 9 of its brief US West cites public testimony in support of allocating the gain to US West. This is a technical issue on which the Commission sought to inform the public and welcomed testimony. It is ironic that counsel for US West has argued successfully that public testimony was an inadequate basis for disallowing expenses associated with executive compensation. Mountain Water v. P.S.C., Cause No. ADV-87-981 Montana First Judicial District 1988. (I have argued that Mountain Water should not be read as a general limit on the use of public testimony.)

Almost everyone recognizes that public acceptability is an appropriate factor in rate design. Bonbright, Principles of Public Utility Regulation 384 (2nd ed. 1988) Does the Applicant now concede that the Commission may directly consider public testimony concerning rate increases ("I didn't get a raise this year"), rate of return ("The bank doesn't pay me twelve percent interest") or compensation ("I work just as hard as they do, for five dollars an hour, and with no expense account")?

C. Least-Cost Telecommunications Planning.

This section is intended to commence a constructive discussion for the future. Any form of regulation, whether "conventional" or "alternative," should be both principled and disciplined. With good intentions, the Commission majority considered itself compelled to depart from sound established principles. One of the primary justifications for economic regulation is that it imposes discipline on industries which are not disciplined by fully-competitive markets. Here, US West has been allowed to use its monopoly position to extract a subsidy from regulated customers in order to help protect itself from anticipated competition.[9] Drawing on the electric integrated resource planning process, it may be feasible to develop a rational public process to ensure customers receive the services they demand, at the least possible cost. Such a process should be grounded in the following principles, all of which are to some degree inconsistent with the Commission's action in this case:

1. Maintain universal and adequate service, including appropriate levels of investment and modernization, and avoidance of inappropriate disinvestment.

[9]Significantly, in an informal Commission hearing concerning US West's "re-engineering" of customer service, US West executives stated they expected to retain an eighty percent market share even after competition arrives in the local exchange. Such a market share would be well beyond any economic measure of market concentration, such as the Herfendahl-Hirshman Index or the Landes-Posner-Lerner Index. See, Landes and Posner, "Market Power in Antitrust Cases," 94 Harvard L. Rev. 937 (1981).

2. Maximize the gains inherent in the telecommunications network (e.g. efficiency and productivity).

3. Constrain exploitative actions including pricing and cross-subsidies from monopoly to competitive activities, recognizing the coexistence of monopoly and competitive markets, and the dynamic nature of telecommunications.

A least-cost telecommunications planning process would probably also need to recognize a number of specifics. First, telecommunications involves customer premises equipment, software and applications, and the network. The network is in fact a network of networks, common carrier, private and publicly-owned, switched and unswitched, land-based and radio. Each element should be considered as part of a least-cost plan.

Second, technology is a means to provide services, not an end in itself. Future modernization of the network would be one part of the plan, but should be driven by customer-demanded services. Other parts might include, for example, ongoing work on "extended area service" and "one-plus" intra-LATA dialing (items which appear inconsistent standing alone, as the first limits competition and the second expands it).

Third, participants should reflect a wide-range of users, including high-volume business and low-tech residential, rural and urban, state agencies and grassroots non-profits. Participants should have access to expertise independent of that provided by the telecommunications industry. Without independent expertise, the procedure would be illegitimate. Resource constraints, including those faced by the Commission, are the greatest barrier to least- cost planning.

Fourth, many but not all aspects of a least-cost plan are under the authority of the Public Service Commission. In part, the plan would seek to make transparent the connection between ongoing Commission dockets. Many aspects of the plan would be outside the Commission's authority, for example expanding use of the various state-owned facilities. This would give least-cost telecommunications planning a broader, public-policy focus than is the case with electric integrated resource planning.

Finally, the process should remain clear-eyed and cold-blooded. It should not be allowed to succumb to the politicization experienced in this case. The three regulatory principles listed above should be kept constantly in mind. If not, the process would generate services as likely to be most-cost as least. That is what happened in this case.

V. CONCLUSION.

Tough cases make bad law. This was an exceptionally tough case. With the very best intentions, the Commission deviates from established policy in pursuit of worthwhile objectives, in which I share. Apart from the direct cost to customers in this case, there are risks of establishing both de jure precedent concerning allocation of gain, and de facto precedent concerning the Commission's willingness to deviate from sound regulation when presented with attractive but "non-negotiable" deals. Having blinked once, it may be more difficult not to blink again. The entire Commission is in agreement that its decision in this case is limited to the very unique facts before it.

RESPECTFULLY SUBMITTED this 24th day of November, 1993.

Bob Rowe

BOB ROWE
Vice Chair